No. 90-1458

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1990

THE WILLIAMS COMPANIES, INC. AND ITS DOMESTIC SUBSIDIARIES, INCLUDING WILLIAMS NATURAL GAS COMPANY, WILLIAMS PIPE LINE COMPANY, WRC OF MISSOURI, INC., AGRICO CHEMICAL COMPANY, WILLCO, INC. (EDGCOMB METALS COMPANY), WILLBROS TERMINAL COMPANY, AND WRC OF CROWN CENTER, INC.,

Petitioners,

v.

DIRECTOR OF REVENUE, STATE OF MISSOURI,

Respondent.

Petition For A Writ Of Certiorari To The Supreme Court Of Missouri

PETITIONERS' REPLY TO RESPONDENT'S BRIEF IN OPPOSITION

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I. QUESTIONS PRESENTED

Missouri law permits (but does not require) an affiliated group of corporations to file a Missouri consolidated income tax return if the affiliated group (i) files a consolidated return for Federal income tax purposes and (ii) derives fifty percent (50%) or more of its income from Missouri sources. Petitioners, an interstate, multicorporate, unitary business, under the umbrella of The Williams Companies, Inc., filed a Federal consolidated return but did not derive fifty percent (50%) or more of their income from Missouri sources for the years at issue. Also, Respondent maintains, and the Missouri Supreme Court held in this case, that Missouri law does not permit the filing of a combined report on a unitary apportionment basis.

For the years at issue, Petitioners initially filed their Missouri corporate income tax returns with the Respondent on a separate corporation basis. Subsequently, Petitioners submitted refund claims to Respondent alternatively on a consolidated return or combined report basis.

Also, during the tax years at issue, one of the Petitioners, Williams Pipe Line Company, sold a preferred stock investment, the gain from which Missouri seeks to tax as apportionable "business income."

The questions presented are:

1. Whether the Missouri Supreme Court erred in denying Petitioners' refund claims on a consolidated return basis because the Missouri statutory requirement that an affiliated group of corporations earn more than

QUESTIONS PRESENTED-Continued

fifty percent (50%) of its income in Missouri as a condition to filing consolidated Missouri income tax returns discriminates against interstate commerce in violation of the Commerce Clause of the United States Constitution?

2. Whether the Missouri Supreme Court erred in upholding Missouri's assessment, which apportions capital gain income derived from the sale of preferred stock to Missouri as "business income" under the Multistate Tax Compact, when the seller had no unitary relationship with the issuing corporation, thereby taxing an activity with which Missouri lacks nexus, in violation of the Due Process Clause of the United States Constitution?

PARTIES TO THE PROCEEDING AND RULE 29.1 STATEMENT

A list naming all parent companies and subsidiaries (except wholly owned subsidiaries) of each corporate Petitioner was included in the Petitioners' Petition For A Writ of Certiorari to the Supreme Court of Missouri at pp. iii-v. There are no amendments to this list needed to make it currently accurate.

TABLE OF CONTENTS

Page

QUESTIONS PRESENTED i

PARTIES TO THE PROCEEDING AND RULE 29.1 STATEMENT iii

THE RESPONDENT'S BRIEF IN OPPOSITION OFFERS NO SOUND REASON WHY THE PETITION SHOULD BE DENIED 2

1. The Missouri Supreme Court's Opinion Upholding the Fifty Percent Source-of-Income Requirement for Filing a Missouri Consolidated Income Tax Return Decided a Federal Question and Was Not Based on Independent Grounds of State Law 2

2. The Issue of the Severability of the Fifty Percent Source-of-Income Requirement for Filing a Missouri Consolidated Income Tax Return from the Remainder of the Statute Was Not Addressed in the Missouri Supreme Court's Opinion and, Accordingly, Is Not Presented in this Proceeding 4

3. The Missouri Supreme Court's Opinion Upholding Apportionment of the WPL Capital Gain as Unitary "Business Income" Decided a Federal Question Under the Due Process Clause in a Way that Conflicts with Decisions of this Court and of the Highest Courts of Other States 7

CONCLUSION 10

TABLE OF AUTHORITIES

Page

CASES

Allen v. Southern Pac. R. Co., 173 U.S. 479 (1899) 3

Container Corp. of America v. Franchise Tax Board, 463 U.S. 159, *reh'g denied*, 464 U.S. 909 (1983) 9

Corning Glass Works, Inc. v. Virginia Dep't. of Taxation, 402 S.E.2d 35 (Va. 1991) 9

Ivanhoe Irrigation District v. McCracken, 357 U.S. 275, *reh'g denied*, 358 U.S. 805 (1958), *overruled on other grounds, California v. United States*, 438 U.S. 645 (1978), *on remand* 509 F. Supp. 867 (E.D. Cal. 1981) 5

Mid-America Television v. State Tax Commission, 652 S.W.2d 674, 680 (Mo. en banc 1983), *cert. denied*, 465 U.S. 1065 (1984) 5

Poafpybitty v. Skelly Oil Co., 390 U.S. 365 (1968) 3

True v. Heitkamp, 1991 WL 80989 (N.D.) 9

United Airlines, Inc. v. Mahin, 410 U.S. 623 (1973) 3

Wardius v. Oregon, 412 U.S. 470 (1973) 3

Zacchini v. Scripps-Howard Broadcasting Co., 433 U.S. 562 (1977) 3

OTHER

Mo. Rev. Stat. § 1.140 (1976) 5

Mo. Rev. Stat. § 143.451 (1976) 6

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PETITIONERS' REPLY TO RESPONDENT'S BRIEF IN OPPOSITION

Petitioners, The Williams Companies, Inc., and its domestic subsidiaries for the tax years at issue, respectfully submit the Petitioners' Reply to Respondent's Brief in Opposition, in support of Petitioners' request for this Court to issue a Writ of Certiorari to review the judgment of the Supreme Court of Missouri entered in this action on November 20, 1990 (the "Missouri Supreme Court's Opinion"). The Petitioners' Petition for a Writ of Certiorari to the Supreme Court of Missouri (the "Petition") was filed with this Court on

March 15, 1991, and the Respondent's Brief in Opposition (the "Respondent's Brief") was filed with this Court on June 6, 1991. This Reply Brief is submitted pursuant to Rule 15.6 of the Rules of this Court and is addressed solely to arguments first raised in the Respondent's Brief.

THE RESPONDENT'S BRIEF IN OPPOSITION OFFERS NO SOUND REASON WHY THE PETITION SHOULD BE DENIED.

1. The Missouri Supreme Court's Opinion Upholding the Fifty Percent Source-of-Income Requirement for Filing a Missouri Consolidated Income Tax Return Decided a Federal Question and Was Not Based on Independent Grounds of State Law.

The Respondent's Brief submits that the Petition should be denied because independent state grounds[1] exist for the Missouri Supreme Court's Opinion which, according to Respondent, must be resolved "before" any decision on the constitutionality of the fifty percent (50%) source-of-income requirement (the "Requirement") for filing a Missouri consolidated income tax return. Respondent's Brief, p. 4. It is true that the Respondent urged the Missouri Supreme Court to decide this case on threshold state law considerations and that the decision of the Missouri Administrative Hearing Commission, the

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[1] The purported independent state procedural grounds involve whether Missouri law permits corporate income tax returns to be amended on an alternative filing basis after an initial filing has been made. The Respondent also asserts that independent state procedural grounds exist because Petitioners' "amended returns should not be considered to be equivalent to consolidated returns." Respondent's Brief, p. 3. The Missouri Supreme Court's Opinion unequivocally rejected this latter contention, holding that "In 1987, appellants filed *consolidated* amended Missouri corporate income tax returns for 1982 through 1984. . . . " Petition, App. 2a (Emphasis added).

intermediate appellate tribunal, had resolved such state procedural issues against the Petitioners. Petition, App. 37a. However, this Court considers "only the final action of the supreme court of the state in disposing of the controversy" and is "unconcerned with the conclusions" of a subordinate appellate tribunal. *Allen v. Southern Pac. R. Co.*, 173 U.S. 479, 489 (1899). The Missouri Supreme Court's Opinion did not address state procedural issues; it unambiguously reached the substantial Federal issue which Petitioners urge this Court to review.

This Court had held that "the possibility that the state court might have reached the same conclusion if it had decided the question purely as a matter of state law does not create an adequate and independent state ground that relieves this Court of the necessity of considering the federal question." *United Airlines, Inc. v. Mahin*, 410 U.S. 623, 630-631 (1973); *Zacchini v. Scripps-Howard Broadcasting Co.*, 433 U.S. 562, 568 (1977). Further, if the opinion of the state's highest court clearly indicates that its decision rested solely on federal grounds, it is presumed that the state court "either rejected or failed to reach the asserted state grounds." *Poafpybitty v. Skelly Oil Co.*, 390 U.S. 365, 375-376 (1968).

Significantly, the Respondent correctly notes that state procedural issues were "not considered by the Supreme Court of Missouri, which instead directed its attention to the issue of whether the statute was unconstitutional. Finding it to be constitutional, the Missouri Court affirmed the Commission's decision without any further discussion of this other issue." Respondent's Brief, p. 4. The Missouri Supreme Court's "willingness to reach the merits of petitioner's federal claims provides convincing proof that the judgment does not rest on adequate state grounds." *Wardius v. Oregon*, 412 U.S. 470, 477 (1973). Indeed, since the state procedural issues are threshold issues, as Respondent acknowledges, by reaching the Federal question, the Missouri Supreme Court

implicitly resolved such state procedural issues in favor of Petitioners.

In short, since the Missouri Supreme Court's Opinion upheld the Requirement on Federal constitutional grounds and not on independent state grounds, a substantial Federal question is properly presented for review by this Court.

2. The Issue of the Severability of the Fifty Percent Source-of-Income Requirement for Filing a Missouri Consolidated Income Tax Return from the Remainder of the Statute Was Not Addressed in the Missouri Supreme Court's Opinion and, Accordingly, Is Not Presented in this Proceeding.

The Respondent's Brief erroneously maintains that a decision by this Court to strike down the Requirement would result in "no taxpayers . . . entitled to file a consolidated return in Missouri . . . because the challenged portion of the Missouri statute is not severable." Respondent's Brief, p. 7. The Missouri Supreme Court's Opinion did not address the severability of the Requirement and, accordingly, such issue is not presented in this proceeding. The severability issue is reached *only* in the event that the Requirement is struck down by this Court, and could properly be considered by the Missouri Supreme Court only on remand. Contrary to the Respondent's contention, the outcome of the severability issue is not foreordained in the Respondent's favor.[2]

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[2] Respondent states that "the obvious intent of the legislature [was] to place a limit on corporations filing consolidated returns in this state, and the removal of the fifty percent requirement from the statute would negate this intent." Respondent's Brief, p. 8. On the contrary, the Missouri Supreme Court has indicated that the intent behind the consolidated return statute was to permit an affiliated group to be

(Continued on following page)

Clearly, the mere possibility that the Missouri Supreme Court could construe the consolidated return statute to deny the filing of any consolidated returns by refusing to sever the Requirement, does not eliminate the need for a determination of the constitutionality of the Requirement by this Court. Indeed, the unstated premise of the Respondent's contention is that since the Requirement may not be severable, there is an independent state ground precluding review of the Missouri Supreme Court's Opinion. On the contrary, it is well established that if a Federal question exists which precedes or "opens the door to the application of the state law," no independent state law basis of decision is presented and the case may properly be considered by this Court. *Ivanhoe Irrigation District v. McCracken*, 357 U.S. 275, 290, *reh'g denied*, 358 U.S. 805 (1958), *overruled on other grounds, California v. United States*, 438 U.S. 645 (1978), *on remand* 509 F. Supp. 867 (E.D. Cal. 1981).

The Respondent also claims that no significant Commerce Clause problem is presented by the Requirement because an affiliated group of taxpayers that satisfies the Requirement is not similarly situated with an affiliated group that does not satisfy the Requirement. According to Respondent, the hypothetical situation presented by Petitioners at pages 16 and 17 of the Petition comparing

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(Continued from previous page)

taxed "somewhat equally with one large corporation." *Mid-America Television v. State Tax Commission*, 652 S.W.2d 674, 680 (Mo. en banc 1983), *cert. denied*, 465 U.S. 1065 (1984). The Requirement is not essential to that intent. Accordingly, the Requirement is not so "essentially and inseparably connected with" the remainder of the consolidated return statute that the whole statute must fall if the Requirement is struck down. Mo. Rev. Stat. § 1.140 (1976). Accordingly, if this issue is reached, the Requirement should be deemed severable from the remainder of the consolidated return statute.

such groups is unsound because the "applicable apportionment factors . . . cannot be determined from the facts given. Thus, it is not possible to calculated [sic] what the true tax outcome would be in this situation." Respondent's Brief, p. 5. On the contrary, the hypothetical situation presented assumed that the *only* difference between the two affiliated groups of taxpayers was the *source* of the groups' income.

To determine whether fifty percent (50%) of an affiliated group's income is derived from Missouri sources, one looks to the geographic location of the group's revenues. The consolidated return filing statute requires that "fifty percent or more of [the group's] income is derived from sources within this state *as determined in accordance with section 143.451* . . . ". Petition, App. 107a (Emphasis added). Section 143.451 identifies Missouri source income on a geographic, receipts basis. Petition, App. 109a-113a.

The hypothetical situation presented in the Petition assumes that the property and payroll factors (the other two apportionment favors in addition to the receipts factor) are the same for both groups of hypothetical taxpayers. Only the receipts factor, representing the source of the groups' income, is different.[3] Therefore, the hypothetical affiliated groups of taxpayers are similarly situated. The hypothetical example properly demonstrates that the Requirement has the "discriminatory effect of taxing the same amount of income *apportioned* to Missouri

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[3] As a result, the Respondent's Brief also incorrectly argues that "the greater the proportion of income a taxpayer derives from Missouri sources, the larger its apportionment factor will be." Respondent's Brief, p. 5. Increasing an affiliated group's income from Missouri sources will increase *only* the receipts factor; it implies nothing with respect to the property and payroll factors which are averaged with the receipts factor to derive the taxpayer's apportionment factor.

by two different groups of affiliated taxpayers at different effective rates. . . . " Petition, p. 16. (Emphasis added).

As the Respondent correctly states, the Requirement is "an integral part of the Missouri scheme for calculating the Missouri taxable income of a group of affiliated taxpayers." Respondent's Brief, p. 5. As "an integral part" of the Missouri tax calculation "scheme," the Requirement is clearly within the reach of this Court's decisions striking down other discriminatory state tax structures, even though the Requirement does not itself "impose tax nor grant a credit or exemption." Respondent's Brief, pp. 5-6.

As a result of this facially discriminatory Requirement, both the location of interstate business and the form in which a taxpayer conducts its interstate business cease to be tax-neutral choices in violation of the Commerce Clause. Therefore, contrary to Respondent's contentions, the Missouri Supreme Court's Opinion upholding the Requirement presents a substantial Federal question and is in conflict with decisions of this Court and of the highest court of another state.

3. The Missouri Supreme Court's Opinion Upholding Apportionment of the WPL Capital Gain as Unitary "Business Income" Decided a Federal Question under the Due Process Clause in a Way that Conflicts with Decisions of this Court and of the Highest Courts of Other States.

Petitioners also contend that the Respondent's attempt to tax the capital gain from the sale by Williams Pipe Line Company ("WPL") of its preferred stock in Wood River Pipeline Corporation ("Wood River") is unconstitutional because WPL did not own a controlling stock interest in Wood River and did not exercise control by any other means. The Respondent suggests that the Missouri Supreme Court's Opinion found that WPL had "implicit" control over Wood River. Respondent's Brief, p. 11. Nowhere in the Missouri Supreme Court's Opinion is there any indication that the Court determined from

the facts that WPL controlled Wood River in any fashion; the contrary, the Court expressly held that "Koch Industries, Inc., controlled" Wood River. Petition, App. 9a.[4] Moreover, to assert, as the Respondent does, that the sundry maintenance, repair, and construction services that WPL provided to Wood River somehow constituted "physical control" of Wood River by WPL is to misconstrue the meaning of "control." The services which WPL performed were fully compensated pursuant to a formal agreement and were subject to the approval of Wood River and, thus, of Koch. The Respondent appears to suggest that WPL could somehow have "controlled" Wood River at the same time that Koch did, yet "control" means ultimate authority, something that, by definition, can only be held by one individual. Surely this is why this Court has never found that an investor and an investee formed a single unitary business where a third entity owned a majority interest in the investee.

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[4] The Respondent's Brief contains several quotations from and citations to the opinion of the Missouri Administrative Hearing Commission (the "Commission") in this matter. The Respondent misleadingly implies that the facts found by the Commission concerning WPL's relationship with Wood River were accepted in their entirety by the Missouri Supreme Court. As the Respondent is well aware, the Petitioners previously have argued that several of the Commission's findings of fact were not supported by the record. The Missouri Supreme Court's Opinion did not reach this issue, because it held that the undisputed facts in this case, by themselves, provided sufficient grounds for holding that Wood River was part of WPL's unitary business. Petition, App. 11a ("[i]t is unnecessary to reach the question of whether certain other findings of fact that appellants dispute are supported by the record"). While the Petitioners also contend that the Respondent could not constitutionally tax the WPL capital gain even if all of the facts as set forth by the Commission were accurate, it is clear that the Missouri Supreme Court's Opinion was not predicated on the accuracy of all of the Commission's findings of fact.

The Respondent also suggests that there is some significance to the fact that WPL would have gained the right to elect a majority of Wood River's directors if Wood River "defaulted" by failing to pay any preferred dividend within 36 months of its scheduled declaration date. It is undisputed, however, that Wood River never defaulted on any preferred dividend. Petition, App. 30a. The existence of the default provision is no more constitutionally meaningful than the possibility that WPL could have elected a majority of Wood River's directors if it had purchased a majority of Wood River's common stock from Koch – both scenarios are entirely conjectural and thus utterly irrelevant to the issue of whether WPL and Wood River constituted a single unitary business.

The existence of control is not "just one consideration in determining the scope of the unitary business." Respondent's Brief, p. 11. Rather, it is a *"prerequisite"* to the existence of a unitary business relationship. *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 177, n. 16, *reh'g denied*, 464 U.S. 909 (1983) (Emphasis added). In finding that Wood River was a part of WPL's unitary business despite the fact that WPL did not control Wood River, the Supreme Court of Missouri has reached a result contrary to the decisions of this Court and of the highest courts of other states. *See Corning Glass Works, Inc. v. Virginia Dep't. of Taxation*, 402 S.E.2d 35, 40 (Va. 1991) (holding that a unitary business relationship legally could not have existed where the investor corporation had been barred from exercising control by the terms of an antitrust consent decree); *True v. Heitkamp*, 1991 WL 80989 (N.D.) (corporations did not form a unitary business because no one individual within the unitary group controlled all members of th group).

CONCLUSION

For the foregoing reasons, there are special and important reasons that a Writ of Certiorari should be issued to the Supreme Court of Missouri.

Respectfully submitted,

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